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Date: February 6, 2015

Legend

Grantor

Spouse

Trust

State 1

State 1 Statute 1

Charity 1

Charity 2

Charity 3

Charity 4

Date 1

Grantor's

Charities

Trustee

Investment

Direction Adviser

Distribution

Adviser

Trust Protector

Company

State 2

State 2 Statute 1

State 2 Statute 2

State 2 Statute 3

State 2 Statute 4

State 2 Statute 5

State 2 Statute 6

Case 1

Case 2

a
b
c
d
e
f
g
h
i

Dear _____ :

This letter responds to your authorized representative's letter dated July 14, 2014, requesting rulings regarding the gift tax consequences of two transfers to Trust and the release of certain powers held by Grantor.

The facts and representations submitted are summarized as follows:

On Date 1, Grantor, a resident of State 2, created Trust to benefit Grantor and three-named charities, Charity 1, Charity 2, and Charity 3. Trust is irrevocable and is sited in State 1. Grantor initially funded Trust with \$c.

The fiduciaries include Trustee, a corporate trust company, and four Trust Advisers. The four Trust Advisers are: (1) Investment Direction Adviser, a corporation; (2) Distribution Adviser, a five-member limited liability company (LLC); (3) Charitable Distribution Adviser (CDA), who is initially Spouse; and (4) Trust Protector, a five-member LLC. If and when Spouse is no longer able to serve as CDA, Company, a five-member LLC, will serve as CDA. Initially, the same five individuals are members or shareholders and officers of Distribution Adviser, Company, and Trust Protector. None of the individuals are beneficiaries of Trust. It is represented that Charities 1 through 3 are organizations described in § 501(c)(3) of the Internal Revenue Code. Charities 1, 2, and 3 and any replacement charity are referred to as Grantor's Charities. It is represented that Charity 4 is also an organization described in § 501(c)(3). Under Trust, Charity 4 may receive distributions indirectly through one or more of Grantor's Charities.

Distributions to Grantor

Article I(b)(1)(i) of Trust provides that, during Grantor's life, the Trustee, at the direction of the Distribution Adviser, shall distribute to Grantor quarterly payments of

h percent of the value of the Trust assets determined pursuant to Article XXIV(c) as of the end of the calendar year (Grantor's Quarterly Distributions).

Article I(b)(2) provides that, during Grantor's life, the Trustee, at the direction of the Distribution Adviser, shall distribute to Grantor first from income and, to the extent income is not sufficient, from principal, such amounts as necessary to maintain Grantor in his accustomed standard of living and an additional amount up to the difference between the Grantor's Quarterly Distributions in the preceding year and the payment due under Article I(b)(1)(i) in the current year (Grantor's Support Distributions).

Article I(b)(4) provides that the Trustee shall have the discretion, exercisable at any time, at the direction of the Distribution Adviser, to distribute any part or all of the income and principal of the Trust to Grantor (Grantor's Special Contingent Distributions) in the event that during Grantor's life the Trust Protector determines in its discretion that any law, regulation, ordinance, judicial decision, or other rule enforceable by any governmental body that is adopted after Date 1 has the result that a material tax, assessment, fee, penalty or other charge or required payment is imposed on Trust or on the recipient with respect to the transfer of Trust assets to any exempt charitable organization to which transfers are permitted under the trust provisions.

Distributions to Grantor's Charities

Article I(b)(1)(ii) provides that, during Grantor's life, the Trustee, at the direction of the Distribution Adviser, shall distribute \$b, each quarter, to Charity 1, subject to the condition that any amount in excess of i percent of the total quarterly distributions made to Charity 1 and Charity 2 shall be expended by Charity 1 only to support certain activities (Charity 1 Quarterly Distribution). Article I(b)(1)(iii) provides that, during Grantor's life, the Trustee, at the direction of the Distribution Adviser, shall distribute \$d to Charity 2 each quarter (Charity 2 Quarterly Distribution). These distributions to Charity 1 and Charity 2 are subject to certain restrictions, as provided in Trust.

Pursuant to Article I(b)(3), the Trustee, in the Trustee's discretion, at the direction of the Distribution Adviser, may at any time and from time to time distribute part of all of the Trust estate during Grantor's life to any one or more of Grantor's Charities, provided Charity 1 receives at least i percent and Charity 2 receives at least e percent of the aggregate distributions to Grantor's Charities (Charity Discretionary Distributions).

Grantor's Veto Powers and Testamentary Limited Power of Appointment

Article I(c) grants Grantor certain veto powers over distributions to Grantor and to Grantor's Charities. Article I(c)(1)(i) provides that, during Grantor's life, Grantor has the right to veto, at any time and from time to time, in whole or in part, for any reason or for no reason, any Grantor Quarterly Distribution, Grantor Support Distribution, Grantor

Special Contingent Distribution, and Charity Discretionary Distribution. (Grantor's Sole Discretionary Veto Powers).

Pursuant to Article I(c)(2)(ii) through (iv), Grantor may veto certain distributions to Grantor's Charities based on certain objective standards (Grantor's Sole Objective Veto Powers). Pursuant to Article I(c)(2)(ii), Grantor may veto any other distributions to Grantor's Charities if Grantor has made a good faith determination that the charity is not fulfilling the purposes for which it was created, as provided in the article. Under Article I(c)(2)(iii), Grantor may veto any Charity 2 Quarterly Distribution to Charity 2 if Charity 2 has not met certain requirements regarding distributions to Charity 4 or Charity 4 has failed to meet certain requirements, as provided in the article. Pursuant to Article I(c)(2)(iv), Grantor may exercise his power to veto any Charity 1 Quarterly Distribution to Charity 1 if Charity 1 has failed to meet certain reporting requirements as provided in the article.

Article I(c)(2) provides that Grantor may veto any Charity 1 Quarterly Distribution to Charity 1 and any Charity 2 Quarterly Distribution to Charity 2 for any reason or no reason, provided that the then serving CDA consents to the veto and the CDA does not have a substantial adverse interest to the Grantor with respect to these distributions within the meaning of § 25.2511-2(e) (Grantor's Consent Veto Power). However, if the CDA is not serving or is substantially adverse to Grantor, then the Trust Protector, if one is serving and does not have a substantial adverse interest to Grantor with respect to these distributions, must consent to the veto. The determination of whether the CDA or the Trust Protector has a substantial adverse interest to Grantor, with respect to the disposition of the Trust assets or income within the meaning of § 25.2511-2(e) is made by the Trust Protector (with the advice of tax counsel). If the value of the Trust assets in the immediate preceding quarter falls below a certain amount determined under Article I(b)(1)(iv), Grantor may exercise this veto power without the consent of the CDA.

Article I(c)(3) provides that Grantor may, at any time or from time to time, release any one or more of the veto powers listed above by providing notice to the Trust Advisers and the Trustee.

Article I(f) grants Grantor a testamentary limited power to appoint the trust estate to Spouse, Grantor's Charities, or two other charities (Grantor's Testamentary Power). Grantor may not appoint any Trust property in favor of Grantor, Grantor's creditors, Grantor's estate, or the creditors of Grantor's estate. In the event that Grantor fails to exercise effectively the limited power of appointment, the remainder of Trust will be distributed f percent to Charity 1 and g percent to Charity 2.

Article IX provides that the Investment Direction Adviser has powers limited to investment decisions regarding Trust assets. Article X provides that the Distribution Adviser serves in a fiduciary capacity and has the full power to direct the Trustee to distribute income and principal of Trust pursuant to the provisions of Trust and subject

to Grantor's veto powers. The Trust Protector has the power to remove any Distribution Adviser and appoint a successor. Article XI provides that the CDA holds the powers granted in Article I, including the power to consent or not to Grantor's veto of Charity 1 and Charity 2 Quarterly Distributions. The Trust Protector has the power to remove any CDA and appoint a successor. Article XII provides that the Trust Protector has the powers already described and other powers that do not include any powers regarding distributions from Trust.

Article XXI(b) provides, in relevant part, that an individual is considered incapacitated if (i) during any period that such individual is legally incompetent as determined by a court of competent jurisdiction, (ii) during any period that a conservator or guardian for such individual has been appointed, based upon his or her incapacity, or (iii) during any period that a certification is in effect that has been issued by two physicians who have examined the individual at issue and who certify to the trustee that such individual, as a result of illness, accident, age, or other cause, no longer has the capacity to act prudently and effectively in financial affairs.

Grantor proposes to release the Grantor's Sole Objective Veto Powers and retain only the Grantor's Consent Veto Power and Grantor's Sole Discretionary Veto Powers. Grantor also proposes to transfer property, in excess of \$a, to Trust (Proposed Transfer) after he releases the Grantor's Sole Objective Veto Powers. Grantor's Consent Veto Power and Grantor's Sole Discretionary Veto Powers will be referred to collectively as "Grantor's Veto Powers."

Further, Grantor intends to execute a springing durable special power of attorney to permit the attorney-in-fact to exercise Grantor's Veto Powers only at such times Grantor is incapacitated (as defined in Trust). The draft document provides that, in the event that Grantor is incapacitated, as defined under Article XXI(b) of Trust, an attorney-in-fact will have the authority and the duty either to exercise or to decline to exercise any veto powers held by Grantor under Trust. The attorney-in-fact cannot serve as a director, trustee, or officer of one of Grantor's Charities and cannot be a Trust Adviser. The power of attorney will become effective upon the Grantor's incapacity and shall terminate upon Grantor's death. Grantor reserves the right to revoke the power of attorney at a time when the Grantor is not incapacitated. The language of Trust will be amended to provide that at any time an attorney-in-fact is named and Grantor is incapacitated, for all purposes the attorney-in-fact shall have all the same rights, powers, duties and authorities with respect to the exercise and non-exercise of the veto powers as are held by Grantor under Trust. The attorney-in-fact shall not have the power to release any of the veto powers in Grantor's name.

You have requested the following rulings:

1. The Date 1 transfer and the Proposed Transfer of property to Trust by Grantor is and will be treated as wholly incomplete gifts for gift tax purposes.
2. When Grantor releases his right to exercise his Grantor's Objective Veto Powers, but retains Grantor's Veto Powers and Grantor's Testamentary Power, such release will not result in a completed gift of the Date 1 transfer or the Proposed Transfer of property to Trust.
3. Should Grantor become incapacitated and unable to exercise the Grantor's Veto Powers and the Grantor's Testamentary Power, such incapacity will not result in a completed gift of the Date 1 transfer or the Proposed Transfer of property to Trust.
4. Should Grantor execute a springing durable power of attorney which gives the attorney-in-fact the authority to exercise Grantor's Veto Powers, the existence of the springing durable power of attorney will not result in a completed gift of the Date 1 transfer or the Proposed Transfer of property to Trust.
5. Section 2702 does not apply to the Date 1 transfer or the Proposed Transfer of property to Trust by Grantor.

LAW AND ANALYSIS

Ruling 1

Section 2501(a)(1) imposes a tax for each calendar year on the transfer of property by gift by an individual. Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that a gift is complete as to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in the donor no power to change its disposition, whether for the donor's own benefit or for the benefit of another. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

Section 25.2511-2(b) also provides an example where the donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among the donor's descendants. The example concludes that no portion of

the transfer is a completed gift. However, if the donor had not retained a testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift.

Section 25.2511-2(c) provides that a gift is incomplete in every instance in which a donor reserves the power to revest the beneficial title in himself or herself. A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

Section 25.2511-2(f) provides that the relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by death of the donor, is regarded as the event which completes the gift and causes the gift tax to apply.

In Estate of Sanford v. Comm'r, 308 U.S. 39 (1939), the taxpayer created a trust for the benefit of named beneficiaries and reserved the power to revoke the trust in whole or in part, and to designate new beneficiaries other than himself. Six years later, in 1919, the taxpayer relinquished the power to revoke the trust, but retained the right to change the beneficiaries. In 1924, the taxpayer relinquished the right to change the beneficiaries. The Court stated that the taxpayer's gift is not complete, for purposes of the gift tax, when the donor has reserved the power to determine those others who would ultimately receive the property. Accordingly, the Court held that the taxpayer's gift was complete in 1924, when he relinquished his right to change the beneficiaries of the trust. A grantor's retention of a power to change the beneficial interests in a trust causes the transfer to the trust to be incomplete for gift tax purposes, even though the power may be defeated by the actions of third parties. Goldstein v. Comm'r, 37 T.C. 897 (1962). See also Estate of Goelet v. Comm'r, 51 T.C. 352 (1968).

In this case, Grantor retained Grantor's Testamentary Power to appoint the property in Trust to Spouse, Grantor's Charities, and two other named charitable organizations. Under § 25.2511-2(b) the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, based upon the facts submitted and the representations made, we conclude that the retention of this power causes the Date 1 transfer to Trust to be incomplete with respect to the remainder interest in Trust. If Grantor retains the Grantor's Testamentary Power, the Proposed Transfer of property to Trust will also be an incomplete gift of the remainder in Trust. If at any time, Grantor releases the Grantor's Testamentary Power, such release will result in a completed gift of the remainder interest in Trust.

In this case, the Date 1 transfer is also an incomplete gift of the lifetime interests in Trust for the following reasons. Grantor retained the Grantor's Sole Discretionary

Veto Powers to veto discretionary distributions to Grantor's Charities and quarterly, support, and contingent distributions to Grantor. Grantor also retained the Grantor's Sole Objective Veto Powers and Grantor's Consent Veto Power to veto quarterly distributions to Grantor's Charities. Pursuant to these powers, at the time of the Date 1 transfer to Trust, Grantor retained the right to veto any distributions of income and principal to any one or more of Grantor's Charities during his lifetime.

Under § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries. In this case, Grantor's Sole Discretionary Veto Powers, Grantor's Consent Veto Power, and Grantor's Sole Objective Veto Powers give Grantor the power to change the interests of the beneficiaries during his lifetime. Accordingly, based upon the facts submitted and the representations made, we conclude that the retention of these veto powers causes the Date 1 transfer to Trust to be an incomplete gift of the lifetime interests in Trust.

Ruling 2

Grantor proposes to release the Grantor's Sole Objective Veto Powers, while retaining the Grantor's Consent Veto Power and Grantor's Sole Discretionary Veto Powers (Grantor's Veto Powers). Grantor's Sole Discretionary Veto Powers give Grantor the power to veto any Charity Discretionary Distributions to Grantor's Charities during Grantor's lifetime. Grantor's Consent Veto Power gives Grantor the power to veto any quarterly distribution to Grantor's Charities for any reason or for no reason, with the consent of the CDA, during Grantor's lifetime. Further, if the value of the Trust assets in the immediate preceding quarter falls below a certain amount determined under Article I(b)(1)(iv), Grantor may exercise this veto power without the consent of the CDA.

Section 25.2511-2(e) provides that a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. Section 25.2511-2(e) does not define "substantial adverse interest." Section 25.2514-3(b)(2) provides that a coholder of the power has no adverse interest merely because of his joint possession of the power or merely because he is a permissible appointee under a power. At least one court has considered whether a person's interest in a trust was a "substantial adverse interest" for purposes of § 25.2511-2(e).

In Camp v. Comm'r, 195 F.2d 999, 1004 (1st Cir. 1952), the donor reserved the power to revoke a trust in conjunction with his half-brother or his mother. The trust provided for income to donor's wife during her lifetime, and upon her death, the principal of the trust would be paid to his mother, for her life, and upon her death, to his half-brother. The court concluded that since the mother and the half-brother had no interest in the life estate for the wife, that neither the interests of the mother or the

half-brother were adverse to the withdrawal of the life estate for the wife. The court stated that the regulation, the predecessor to § 25.2511-2(e), recognizes realistically that when the donor has reserved the power to withdraw any of the donated interests with the concurrence of some third person who has no interest in the trust adverse to such withdrawal, it is in substance the same as if the donor had reserved such power in himself alone. See *also Paxton v. Comm'r*, 57 T.C. 627 (1972) (Paxton's interest in the trust, whether regarded as substantial or insignificant, would not be adversely affected by the exercise or nonexercise of the power he possesses with respect to the trust because his interest will not change or be adversely affected, for purposes of the predecessor of § 672.); *Joseloff v. Comm'r*, 8 T.C. 213 (1947) (Revocation of trust by Grantor with wife's consent would not be an act that is adverse to the interests of the wife for purposes of the predecessor of § 672.).

The Internal Revenue Service considered the same question in the context of § 2041. In Rev. Rul. 79-63, 1979-1 C.B. 102, decedent's spouse, who died in 1972, created a testamentary trust under the terms of which the trust income was payable to the decedent for life, and the remainder was payable equally to the decedent's children or to any one of such children as the decedent might direct by will. In addition, the trust terms provided that at any time during the decedent's lifetime the decedent, with the consent of A, one of the decedent's children, could direct the trustees to distribute all or any part of the trust property to anyone, including the decedent. Under the terms of the governing instrument, the decedent and A were trustees of the trust and they continued in those positions until the decedent's death in 1977. The question presented was whether any amount of the trust property is includible in the decedent's gross estate under § 2041 as the value of property subject to a general power of appointment, in view of the fact that the power held by the decedent was exercisable only with the consent of A. The revenue ruling concludes that A is a taker in default not of the lifetime power in which A has a power of consent but rather of the testamentary power exercisable solely by the decedent. In such a situation A would not have necessarily been in a better economic position after the decedent's death by refusing to exercise the power in favor of the decedent during the decedent's lifetime. Thus, the fact that A might survive the decedent and receive an interest in the property, if the decedent failed to exercise the testamentary power in favor of persons other than A, does not elevate A's interest as a consenting party of the lifetime power to a substantial adverse interest.

In this case, Spouse's interest will be adverse to the exercise of Grantor's Consent Veto Power if the exercise of Grantor's Consent Veto Power will diminish or eliminate Spouse's significant economic interest in the property subject to Grantor's power. In this case, Grantor reserved the power to veto quarterly distributions to Charity 1 and Charity 2. Spouse has no interest adverse to such distributions. Spouse is merely a permissible appointee of the remainder of Trust. Spouse's interest as a permissible appointee does not elevate Spouse's interest as a consenting party of the lifetime power to a substantial adverse interest. Further, Spouse's consent to Grantor's

veto would benefit the permissible appointees, including Spouse, because a veto of a quarterly distribution would result in the accumulation of that amount in Trust.

Further, Spouse's interest as a permissible appointee is not a substantial interest for purposes of § 25.2511-2(e). Section 25.2514-3(b)(2) provides that an interest adverse to the exercise of a power is considered as substantial if its value in relation to the total value of the property subject to the power is not insignificant. Several cases in which the courts considered whether a contingent remainder is a substantial interest for purposes of the predecessor of § 672 concluded that a contingent remainder is not a substantial interest. See Chase Nat'l Bank of New York v. Comm'r, 225 F.2d 621 8th Cir. 1955); Trust f/b/o McDonald v. Comm'r, 19 T.C. 672 (1953); Joseloff v. Comm'r, 8 T.C. 213 (1947) ; Savage v. Comm'r, 4 T.C. 286 (1944); Holt v. United States, 669 F. Supp. 751 (D.C. W.D. VA. 1987). The same rationale applies in determining whether Spouse's interest as a permissible appointee is a substantial interest. Spouse is only one of four permissible appointees. In default of the exercise of Grantor's Testamentary Power, Trust assets will be distributed to Charity 1 and Charity 2. We conclude that Spouse's interest as a permissible appointee is insignificant for purposes of § 25.2511-2(e). Accordingly, we conclude that Spouse's interest is not an adverse substantial interest for purposes of § 25.2511-2(e).

If Spouse ceases to serve as CDA, a five-member LLC will serve as CDA. The LLC and none of its members are income or remainder beneficiaries of Trust. Therefore, the LLC members do not have substantial adverse interests to the exercise of Grantor's Consent Veto Power. Further, both Spouse and the successor CDA are prohibited from exercising the consent power if Spouse or the successor CDA have substantial adverse interests to the Grantor Consent Veto Power. In such a case, the Trust Protector has the power to consent to this power. The Trust Protector is not a beneficiary of the trust and does not have a substantial adverse interest to the exercise of Grantor's Consent Veto Power.

In conclusion, because the CDA, either Spouse or the LLC, or in default, the Trust Protector, does not have a substantial adverse interest to Grantor's Consent Veto Power, under § 25.2511-2(e), Grantor is considered as having himself the power to veto any Charitable Quarterly Distribution to Grantor's Charities for any reason and for no reason. Accordingly, based upon the facts submitted and representations made, we conclude that the Proposed Transfer of property to Trust will be an incomplete gift, assuming Grantor retains Grantor's Consent Veto Power, Grantor's Sole Discretionary Veto Power, and Grantor's Testamentary Power.

Furthermore, while the Proposed Transfer of property to Trust will not result in a completed gift, a distribution from Trust to Grantor's Charities will be a completed gift from Grantor to that charity. A distribution from Trust to Grantor will be considered as a return of capital and will not be considered a completed gift. Upon Grantor's death, the

fair market value of the property in Trust is includible in Grantor's gross estate for federal estate tax purposes.

Ruling 3

State 1 law, the state where Trust is sited, allows the Trustor's state of residence, in this case, State 2, to control the guardianship of property. State 1 Statute 1.

In Rev. Rul. 75-350, 1975-2 C.B. 366, husband's will provided for the creation of a trust for the benefit of his wife. The trust granted wife a testamentary general power of appointment. Under state law, wife was legally incapable of executing a will from the time her husband died until her death. Upon wife's death, the trust passed to her children in default of wife's power of appointment over the trust. The Service considered whether the trust principal was includible in the wife's gross estate under § 2042(a)(2) in view of her legal incapacity during the existence of the trust. The Service stated that the requirements of § 2041 require only that the decedent has at the time of death a general power of appointment which is exercisable. Further, the practical inability to exercise or release a general power did not affect the existence of the power at her death. Therefore, incapacity is immaterial in view of the requirements of § 2041. The Service ruled that the trust property was includible in wife's gross estate because wife held a general power of appointment under § 2041. *See also* Rev. Rul. 55-518, 1955-2 C.B. 384 (The Service ruled that property subject to the power to alter, amend, revoke, or terminate is includible in the powerholder's gross estate if the power exists at the date of death regardless of the manner in which it may be exercised.).

In Estate of Alperstein v. Comm'r, 613 F.2d 1213 (2nd Cir. 1979), *aff'g*. 71 T.C. 351 (1978), husband's will established a trust for the benefit of his wife (decedent) and granted decedent a testamentary general power of appointment over the trust. Subsequent to husband's death, a state court declared decedent incompetent. Decedent lacked capacity from husband's death until her death. The Service included the trust property in decedent's gross estate under § 2041(a)(2). Decedent's counsel claimed that because of the decedent's incompetence she was never able after her husband's death to exercise the power vested in her by his will and, thus, the property subject to the general power of appointment should not be included in decedent's estate under § 2041. The Court of Appeals held that:

on the basis of statutory language, legislative history . . . of § 2041(a)(1) . . ., administrative interpretation and case law, that when an instrument has conferred a testamentary power which by its terms can be exercised in favor of the donee's estate, the property subject to the power is part of the donee's gross estate even though the donee, by virtue of incompetency, was unable to make a valid will at any time after the power was granted.

Id. at 1221-1222. See also Estate of Gilchrist v. Comm'r, 630 F.2d 340 (5th Cir. 1980); Pennsylvania Bank and Trust Co. v. United States, 597 F.2d 382 (3rd Cir. 1979); Fish v. United States, 432 F.2d 1278 (9th Cir. 1970).

Section 25.2511-2(b) provides that if upon the transfer of property (whether in trust or otherwise) the donor *reserves* any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. [Emphasis added]. The statute and regulations under § 2511 require only that the donee reserve the power to make the gift incomplete. In this case, as in Rev. Rul. 75-350 and the cases cited above, Grantor, if incapacitated, will continue to have reserved the Grantor's Veto Powers and Grantor's Testamentary Power. Incapacity is not a release or termination of Grantor's Veto Powers for purposes of § 25.2511-2(f). The practical inability of Grantor to exercise his veto powers due to his incapacity does not affect the existence of the power. Accordingly, as in Rev. Rul. 75-350 and the cases cited above, Grantor's incapacity will not cause a completed gift to occur provided the Grantor does not release such powers prior to incapacity.

Accordingly, based on the facts submitted and the representations made, we conclude that should Grantor become incapacitated and unable to exercise Grantor's Veto Powers or Grantor's Testamentary Power, his incapacity will not result in a completed gift of the Date 1 transfer or the Proposed Transfer of property to Trust on the date when Grantor is declared incapacitated, assuming Grantor has not released any of these powers prior to being declared incapacitated.

Ruling 4

Grantor intends to execute a springing durable power of attorney that would be effective if Grantor becomes incapacitated, as defined in Trust, and would give the attorney-in-fact Grantor's Veto Powers. In Comm'r v. Estate of Bosch, 387 U.S. 456 (1967), the Court held that, where the issue involved is the determination of property interests for federal estate tax purposes and the determination is based on state law, the highest court of the state is the best authority on its own law. The Court held that, if there is no decision by the state's highest court, federal authorities must apply what they find to be the state law after giving proper regard to relevant rulings of other courts. In this case, State 2 case law and statutory law recognize the validity of a durable power of attorney and State 2 statutory law specifies the rights or limitations of the attorney-in-fact with respect to veto powers.

In Case 1, the court addressed whether gifts of the principal's property made by an attorney-in-fact under a durable power of attorney were includible in the principal's gross estate where the power of attorney did not authorize the giving of such gifts. The court stated that the legal effect of gifts made pursuant to a power of attorney is

determined according to state law. Case 1. In Case 1, the court stated that the court must decide State 2 law issues as it concludes the State 2 Supreme Court would, citing Estate of Bosch. The court defined a power of attorney as “a written authorization to an agent to perform specified acts in behalf of his principal,” citing Case 2. *Id.* When a power of attorney is executed, a fiduciary relationship between the principal and the attorney-in-fact is created. *Id.* There are many obligations which arise under such a relationship, not the least of which is the agent’s duty to act exclusively in the interest of the principal and forego any personal advantage aside from compensation in the exercise of his or her work. *Id.* While a power of attorney is merely a formalized agency agreement, it must be in writing in order to be valid and effective. *Id.* The court concluded that the power of attorney did not authorize the giving of the gifts and, therefore, under State 2 law, the gifts were void and, thus, includible in the principal’s gross estate.

Under State 2 Statute 1, a “fiduciary” includes an attorney-in-fact under a power of attorney. State 2 Statute 2 provides that in a power of attorney, a principal may grant authority to an attorney-in-fact to act on the principal’s behalf with respect to all lawful subjects and purposes or with respect to one or more express subjects or purposes. The attorney-in-fact may be granted authority with regard to the principal’s property, personal care, or any other matter. All acts done by an attorney-in-fact pursuant to a durable power of attorney during any period of incapacity of the principal have the same effect and inure to the benefit of and bind the principal and the principal’s successors in interest as if the principal had capacity. State 2 Statute 3. An attorney-in-fact has a duty to act solely in the interest of the principal. State 2 Statute 4. If a power of attorney grants limited authority to an attorney-in-fact, the attorney-in-fact has the authority granted in the power of attorney, as limited with respect to permissible actions, subjects, or purposes. State 2 Statute 5. A power of attorney may not be construed to grant authority to an attorney-in-fact to perform the power to revoke a gift of the principal’s property in trust unless expressly authorized in the power of attorney. State 2 Statute 6.

In this case, State 2 Statute 2 authorizes the principal to execute a springing durable power of attorney. Under State 2 Statute 6, if the instrument expressly provides that the attorney-in-fact may veto a gift, the instrument is construed to grant such powers. Therefore, in this case, the execution of a springing durable power of attorney that expressly gives the attorney-in-fact the authority to exercise Grantor’s Veto Powers is valid under State 1 law. Pursuant to State 2 Statute 3, the attorney-in-fact acts on behalf of the principal. The fact that an attorney-in-fact is acting on the Grantor’s behalf does not cause Grantor to release or terminate such veto powers and, therefore, the execution of the springing durable power of attorney is not a release or termination of Grantor’s Veto Powers under § 25.2511-2(f).

Further, if Grantor is declared incapacitated and the springing durable power of attorney becomes effective, Grantor's incapacity will not cause a release or termination of Grantor's veto powers. See Ruling 3.

Finally, if the attorney-in-fact exercises one of Grantor's Veto Powers, such exercise does not result in a distribution from Trust. The attorney-in-fact is acting on behalf of the Grantor and the exercise of the veto power not does result in a completed gift. However, if the attorney-in-fact does not exercise such veto powers and the Trustee distributes Trust income and/or principal to any beneficiary, other than to Grantor or on Grantor's behalf, the distribution is a completed gift by Grantor and not the attorney-in-fact, even though Grantor is incapacitated at the time. Accordingly, based on the facts presented and the representations made, we conclude that the existence of the springing durable power of attorney does not result in a completed gift of the Date 1 transfer or the Proposed Transfer of property to Trust.

Ruling 5

Section 2702 provides special valuation rules in the case of transfers of interests in trusts. Under § 2702(a)(1), solely for the purpose of determining whether a transfer of an interest in trust to or for the benefit of a member of the transferor's family is a gift (and the value of such transfer), the value of any interest in such trust retained by the transferor or any applicable family member (as defined in § 2701(e)(2)) shall be determined as provided in § 2702(a)(2).

Section 2702(a)(2) provides that the value of any retained interest that is not a qualified interest shall be treated as being zero. The value of any retained interest that is a qualified interest is determined under § 7520.

Section 2702(a)(3)(i) provides that § 2702 does not apply to a transfer if the transfer is an incomplete gift. Section 2702(a)(2)(B) defines an incomplete gift as any transfer which would not be treated as a gift whether or not consideration was received for such transfer.

Section 25.2702-1(c)(1) of the Gift Tax Regulations provides that § 2702 does not apply to a transfer, no portion of which would be treated as a completed gift without regard to any consideration received by the transferor.

In this case, the Date 1 transfer to Trust by Grantor is incomplete as to both the lifetime interests and the remainder interests. Therefore, no portion of the transfer is a completed gift. Under § 2702(a)(3)(i), § 2702 does not apply to a transfer that is an incomplete gift. Accordingly, based on the facts submitted and the representations made, we conclude that § 2702 does not apply to the Date 1 transfer to Trust by Grantor and, if Grantor retains both the Grantor's Consent Veto Power and the

Grantor's Testamentary Power at the time of the Proposed Transfer of property to Trust, we conclude that § 2702 will not apply to this transfer.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

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